

**UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MONTANA**

In re

ROBERT EUGENE AGNEW,

Debtor.

Case No. **04-62073-7**

DONALD W. TORGENRUD, JR.,

Plaintiff/Counter-
Defendant,

Adv No. **04-00103**

-VS-

SUSAN L SMITH,

Defendant/Counter-
Claimant.

-VS-

ROBERT EUGENE AGNEW,

Counter-Defendant.

O R D E R

At Butte in said District this 15th day of November, 2005.

In the above-captioned adversary proceeding and Chapter 7 bankruptcy case the following matters were consolidated for trial in this adversary proceeding¹: (1) The Trustee/Plaintiff's preference action against the Defendant Susan L. Smith ("Smith") based upon 11 U.S.C. §§ 547(b) and 550 to avoid Smith's judicial lien against certain real property listed in the Debtor's Schedule A; (2) Smith's counterclaim asserting the imposition of a constructive trust against the real property; (3) Smith's motion to modify stay filed in the main bankruptcy case on July 23, 2004 (Docket No. 7); (4) Smith's objection, filed July 23, 2004, to Debtor's claims of exemptions (Docket No. 8); (4) the Trustee's objections to Debtor's claim of exemptions². After due notice trial of these consolidated matters was held at Missoula on September 9, 2005. The Trustee/Plaintiff Donald W. Torgenrud, Jr. ("Trustee") was represented by attorney Thomas W. Trigg ("Trigg"). Smith was represented by attorney Andrew Pierce ("Pierce"). Debtor Robert Eugene Agnew ("Agnew" or "Debtor") appeared *in propria persona* and testified. Appraiser Richard D. Johns ("Johns") testified as to the market value of real property which is the subject of this proceeding. Plaintiff's Exhibits ("Ex.") 1, 2, 3, 4, 5, 6, and 7, and Smith's Ex. A, B, C³, D, F, G, and H were admitted. At the conclusion of the parties' cases-in-chief the Court closed the record and granted the parties time to file briefs, which have been filed and reviewed by the

¹The parties filed a Stipulation to Consolidate the matters on September 29, 2004, which was approved by Order entered September 30, 2004 (Docket No. 58 in Case No. 04-62073-7).

²The Trustee's objection was filed by the Chapter 13 Trustee on August 30, 2004 (Docket No. 37) in the main case before the case was converted to Chapter 7, and pursued by Torgenrud who later filed Docket No. 64 in this adversary proceeding objecting to the homestead exemption.

³Ex. 4 and C are the same state court findings of fact, conclusions of law and judgment entered on April 8, 2004, in the Montana Twentieth Judicial District Court, Lake County, Cause No. DV-02-14, *Susan L. Smith v. Robert Agnew*.

Court, together with the record and applicable law. These matters are ready for decision.

This Court has jurisdiction of this case under 28 U.S.C. § 1334(b). The pending matters are core proceedings under 28 U.S.C. § 157(b)(2). At issue is: (1) whether Smith is barred by the doctrine of merger and *res judicata* from asserting her counterclaim for constructive trust when the state court judgment entered was silent on her constructive trust claim, even though that judgment is on appeal; (2) if Smith's constructive trust claim is not barred, whether a constructive trust should be imposed on the subject property under Mont. Code Ann. § 72-33-219. For the reasons set forth below, a separate Judgment and Order shall be entered in Smith's favor dismissing the Plaintiff's preference action, denying his motion to avoid Smith's judicial lien, and sustaining the objections to Debtor's homestead exemption. This Memorandum of Decision includes the Court's findings of fact and conclusions of law pursuant to F.R.B.P. 7052 (applying Fed. R. Civ. P. 52 in adversary proceedings).

FACTS

Smith and Agnew were romantically involved but never legally married. Smith and Agnew agreed to acquire certain real property in Lake County, Montana (hereinafter the "subject property"⁴) using Smith's assets, and to jointly improve said property and resell it and split the

⁴The legal description of the subject property from Ex. 4, p. 3 is: "NE1/4, NW1/4 & NW1/4, NE1/4 of Sec 19 T19N, R20W, PMM Lake Co. Mt.". To which Ex. 1, A, B, D add "EXCEPTING THEREFROM a strip of land 30 feet in width along the East line of the NW1/4NE1/4 of Section 19, Township 19 North, Range 20 West, P.M.M., Lake County, Montana." The address of the subject property is listed as 4657 West Post Creek Road, St. Ignatius, MT 59865 on page 1 of Ex. F, but as 4651 West Post Creek Road, Charlo, MT 59824 on Agnew's bankruptcy petition. Schedule A and C list the address as 4657 W Post Creek RD in Charlo.

profits. Ex. 4⁵. Smith contributed \$332,452.00 for the purchase price, labor, materials and miscellaneous expenses to acquire and improve the subject property. Smith purchased the subject property on May 4, 1999, under a buy-sell agreement, and on May 13, 1999, as part of an IRC § 1031 tax deferred exchange agreement assigned her interest in the buy-sell to an entity known as Treasure State Exchange, Inc. (“TSE”). TSE completed the purchase and Smith occupied the property under a lease from TSE. Ex. 4, p. 2.

Agnew persuaded Smith to allow title to the subject property to be transferred to his name for certain tax advantages. Smith agreed based on Agnew’s express written promise to sell the property, reimburse Smith for her expenses and split the profits, dated February 26, 2001, and filed at Lake County Clerk and Recorder on October 22, 2001. Ex. H. Smith permitted TSE to transfer the subject property to Agnew by warranty deed, Ex. 1, which was dated February 26, 2001, and recorded on March 12, 2001. Subsequently, Agnew refused to market or resell the subject property, and admitted that when he accepted the warranty deed, Ex. 1, in his name he never had any intention of selling the subject property and splitting the profit with Smith. Ex. 4, p. 3. Agnew refused Smith’s request for rescission, and refused to transfer title of the property to Smith. Ex. 4, p. 5. On September 18, 2001, Smith executed a lien against the subject property in the amount of \$313,000. Ex. A.

Agnew filed a petition for dissolution of a common law marriage which he alleged he had with Smith, in Cause No. DR-02-48, Montana Twentieth Judicial District Court, Lake County (the “common law marriage dissolution”). That petition was terminated in Smith’s favor, although she incurred \$34,459.24 in attorney fees and emotional distress.

⁵Certain background facts are set forth in Ex. 4/Ex. C.

Smith sued Agnew in the Montana Twentieth Judicial District Court, Lake County, on January 18, 2002, Cause No. DV-02-14, asserting claims for relief to quiet title in the subject property, and to recover damages for fraud, constructive fraud, deceit, breach of contract, Count VI for constructive trust seeking to permanently enjoin Agnew from refusing to convey his interest to Smith⁶, and a claim for unlawful detainer. Ex. 2. On January 28, 2002, in DV-02-14 Smith filed a “Notice of Pendency of Action” (“lis pendens”) describing the subject property and Smith’s claims in the action. Ex. B.

Cause No. DV-02-14 suit was heard in a nonjury trial on March 18, 2004. Ex. 3. The state district court entered on April 8, 2004, “Findings of Fact, Conclusions of Law and Judgment”, Ex. 4/C (“Findings and Conclusions” or “Judgment”) awarding Smith judgment against Agnew in the amount of \$332,452.00 for breach of contract, plus \$100,000 for actual fraud with malice, constructive fraud, deceit with malice, emotional distress caused by malicious prosecution of the dissolution action, plus \$34,459.24 in unpaid attorney fees for a total award of \$466,911.24 plus costs. Ex. 4/C, p. 11.

Smith appealed the district court’s decision in Cause No. DV-02-14 on June 4, 2004, by filing a notice of appeal, Ex. G. That appeal was stayed by the filing of Agnew’s Chapter 13 bankruptcy petition on July 2, 2004, which operated as an automatic stay under 11 U.S.C. § 362(a). Agnew did not appeal, and Trigg ultimately conceded that the appeal time for Agnew

⁶Count VI is entitled “Constructive Trust” and alleges unjust enrichment by Agnew and his breach of an equitable duty. The prayer for Count VI requests not only a permanent injunction against Agnew from refusing to convey the subject property to Smith, but also requests actual damages and costs just like Counts I, II, III, IV, V, and VII. Ex. 2, p. 10.

expired.⁷

Agnew recorded a declaration of homestead on the subject property on June 25, 2004, with the legal description and address of “4651 W. Post Creek Creek” in Charlo. Ex. D. On July 2, 2004, Agnew filed his Chapter 13 petition listing his address as 4651 W Post Creek Rd in Charlo. He filed his Schedules and Statement of Financial Affairs on July 12, 2004. Schedule A lists the subject property with a different number address: “4657 W Post Creek Rd” with a value of \$400,000.00, of which he claimed a homestead exemption on Schedule C, also listing the address as “4657 W Post Creek Rd” in the amount of \$100,000. Schedule D lists Smith as an undersecured creditor with a claim from judgment in the amount of \$468,958 secured by the subject property with an address of “4657 W Post Creek Rd” in Charlo. Agnew’s total liabilities are listed as \$530,604, including \$29,000 in listed unsecured nonpriority claims consisting of purchases, legal fees owed to Clinton Fischer⁸, and a loan from Gene Agnew. Proofs of Claim filed in this case total \$536,541.61, including \$22,509.08 in unsecured nonpriority claims and \$12,647.06 in priority tax claims filed by the IRS.

Debtor filed a Chapter 13 Plan on July 21, 2004, proposing 36 monthly payments of \$58 and selling the subject property and paying the sales proceeds through the Plan after deducting his \$100,000 homestead exemption. Smith filed her motion to modify stay and objection to Agnew’s homestead and other exemptions on July 23, 2004. Agnew filed an objection to

⁷Trigg initially disputed whether the time for Agnew’s appeal had run, but changed his opinion on the record at trial and admitted that Agnew’s time expired. Agnew admitted that he did not appeal, explaining that he did not have the money.

⁸Clinton Fischer filed Proof of Claim No. 7 on November 8, 2004, asserting an unsecured nonpriority claim in the sum of \$13,918.07, for services related to “d/r Susan Smith”.

Smith's motion and counterclaim for violation of the automatic stay. The Chapter 13 Trustee filed objection to Debtor's homestead exemption on August 30, 2004.

This adversary proceeding was commenced by the Debtor against Smith on September 23, 2004, when he filed a complaint to avoid Smith's judicial lien against the subject property as a preferential transfer under § 547(b). By stipulation between Agnew, Smith and the Chapter 13 filed September 29, 2004, and approved by Order entered September 30, 2004, Smith's motion for relief from the stay, Agnew's counterclaim for violation of the stay, and the objections to Debtor's exemptions were consolidated for trial with this adversary proceeding⁹.

Smith filed an answer on October 27, 2004, alleging actual fraud and constructive fraud by Agnew, asserting an equitable lien and seeking equitable relief on the basis of unjust enrichment and a constructive trust in the subject property. After Agnew filed an amended complaint adding claims for relief under F.R.B.P. Rule 7001(2) to determine the validity, priority and extent of Smith's lien, and to avoid Smith's equitable lien and constructive trust under 11 U.S.C. § 544(a), Smith filed an objection and the matter was set for trial.

The hearing on confirmation of Debtor's Plan was set for December 9, 2004, but vacated and continued to April 7, 2005. Smith filed several motions to dismiss the Chapter 13 case. Agnew filed a motion to sell the subject property free and clear of liens on December 15, 2004. The Chapter 13 Trustee filed objections to confirmation on December 17, 2004.

On January 5, 2005, the Debtor filed a motion to convert the case to Chapter 7 based on 11 U.S.C. § 1307(a), which the Court granted and the case was converted to Chapter 7 on January 5, 2005. Torgenrud was added as Chapter 7 Trustee, represented by Trigg, and the

⁹Docket Nos. 55 and 58 in Case No. 04-62073-13.

Chapter 13 Trustee was removed from the case. Based on the conversion to Chapter 7 the Court denied Debtor's motion to sell the subject property on January 11, 2005.

The Court granted the Chapter 7 Trustee time to investigate this litigation and report whether he wished to proceed. The Trustee reported that he had the duty to proceed with trial of the various issues. Debtor's attorney James H. Cossitt moved to withdraw as Debtor's counsel, which was granted by Order entered February 2, 2005.

Torgenrud was added to this adversary proceeding as Plaintiff on March 1, 2005. He filed motions to avoid Smith's judicial lien as a preference and an objection to Agnew's claims of homestead exemption May 20, 2005, in opposition to a motion to dismiss the bankruptcy case filed by Smith¹⁰.

On June 20, 2005, the U.S. Trustee filed a complaint to deny Debtor's discharge. On June 30, 2005, Torgenrud filed motions to amend the complaint again in order to add an equitable claim against Agnew to disallow his homestead exemption, in addition to the claims avoiding Smith's judgment lien as a preference and under § 550. After hearing held on July 7, 2005, the Court granted the Trustee's motion to amend the complaint.

Smith again filed an answer on July 21, 2005, asserting an equitable lien and constructive trust based on the state court judgment, which she argues nevertheless is not a final judgment because it is on appeal to the Montana Supreme Court and stayed by the Debtor's bankruptcy filing, while contending that the same judgment against Agnew is final because he did not appeal. Torgenrud filed a reply requesting Smith's counterclaim be dismissed. Smith filed a motion for summary judgment, which after objections thereto were filed by Torgenrud and

¹⁰Smith's motion to dismiss was denied on July 12, 2005.

Agnew, the Court entered an Order on August 29, 2005 (Docket No. 97), denying Smith's motion because it argued disputed issues of material fact with respect to insolvency and timing, as well as whether the property transferred was an asset of the estate or a constructive trust, and such issues had to be resolved in favor of the nonmoving party on a motion for summary judgment. Trial of this cause proceeded on September 9, 2005.

In the main bankruptcy case, as a result of the U.S. Trustee's complaint objecting to Debtor's discharge in Adversary Proceeding No. 05/00071, and judgment entered therein on July 26, 2005, an Order was entered on August 5, 2005, denying Agnew's discharge pursuant to 11 U.S.C. §727(a)(3), (4), (5) and (6).

Agnew's bank account statement at Glacier Bank of Kalispell dated January 3, 2002, shows a beginning balance of \$10,719.52, 1 deposit of \$772 from US Treasury, and ending balance after 8 checks of \$8,088.96. Ex. 5. Agnew testified that the Glacier Bank checking account was the only checking account he had, and he used it for everyday expenses, a car purchase, and to pay legal fees to Clint Fischer and James H. Cossitt. Ex. 6 consists of several months of Agnew's bank statements for the periods from January 2002, through September 3, 2004, and shows Agnew's account had a positive ending balance at the end of each period. Ex. 7 is Agnew's bank statement for the period ending October 1, 2004, and shows an ending balance of \$3,883.22. Agnew testified that his monthly expenses consumed his income. Based upon the evidence, Pierce renewed Smith's motion for summary judgment on the issue of insolvency at trial, which the Court took under advisement at trial¹¹.

¹¹The insolvency issue underlying Smith's renewed motion for summary judgment is rendered moot based on the Court's decision imposing a constructive trust. None of the other preference elements need be addressed.

Ex. F is an appraisal of the subject property by Johns dated January 7, 2005. Johns testified that the market value of the subject property as shown by Ex. F is \$426,000 as of December 20, 2004. Ex. F, second page. Johns elaborated and testified that the value of the subject property as of April 8, 2004, was \$400,000 based on an annual inflationary rate for real estate in the area of between 8% to 9%.

DISCUSSION

I. Contentions of the Parties.

Torgenrud argues all the elements of preference under § 547(b), including insolvency, are shown as satisfied by the evidence, and that Smith's defense of constructive trust is extinguished under the doctrines of merger, election of remedies, collateral estoppel and *res judicata* by the state court judgment, Ex. 4, which he argues did not impose a constructive trust on the subject property. Torgenrud contends that the state court judgment has preclusive effect even if Smith raised the issue of constructive trust on appeal, citing *Rudolph v. Dussault*, 234 Mont. 449, 451, 763 P.2d 1139, 1140 (Mont. 1988). Torgenrud contends that imposition of a constructive trust "is contrary to the strong policy of the Ninth Circuit against constructive trusts," contrary to the policy of equitable and ratable distribution among creditors under the Bankruptcy Code, and unwarranted in this case. The Trustee argues that imposing a constructive trust would work to the detriment of other creditors such as state and federal taxing authorities, Debtor's former attorney and credit card company which likely would not be paid. The Trustee asks that the Court deny imposition of a constructive trust on the subject property and declare it property of the estate, avoid Smith's judgment lien as a preference, and deny Debtor's claim of homestead

exemption.

Smith argues that she is not prevented by *res judicata* or collateral estoppel from asserting that the property is subject to a constructive trust because the state court judgment is not final as to her because she appealed, though it is final with respect to Agnew and establishes his fraud. Also, Smith contends that the criteria for *res judicata* are not met because the instant preference action and her state court action did not arise out the same transaction or nucleus of facts because the preference action arose only upon the filing of Agnew's bankruptcy petition which happened after entry of the state court judgment.

Smith contends that the property is subject to a constructive trust in her favor because of Agnew's fraud, which arose immediately with his acquisition of the subject property by fraud, and that Agnew and the Trustee have an equitable duty to convey the corpus of the constructive trust to her because it is not property of the estate. Hence, Smith argues, the transfer requirement of § 547(b) is not satisfied because her judgment lien was not a transfer which reduced the amount of the estate available for payment to creditors.

She also claims that the Trustee failed to satisfy the preference element of insolvency which she rebutted with Agnew's bank records, that the Trustee is not entitled to the status of bona fide purchaser under 11 U.S.C. § 544(a)(3), and that the Debtor and other creditors should not benefit from Debtor's fraud. Smith requests judgment dismissing the Trustee's preference claim and denying the Trustee's motion to avoid her judgment lien, and in addition asks the Court to declare the subject property subject to a constructive trust in her favor and direct the Trustee to deliver to Smith title to the Lake County property.

II. Automatic Stay – 11 U.S.C. § 362(c)(2)(C).

The Court begins by disposing of Smith’s motion to modify stay. That motion is moot because Agnew’s discharge was denied as a result of the judgment entered in Adversary Proceeding No. 05/00071 and Order entered in the main case on August 5, 2005. The stay under § 362(a), unless modified earlier pursuant to §§ 362(d), (e) and (f), continues until the time a discharge is granted or denied. § 362(c)(2)(C). The denial of Agnew’s discharge terminated the stay. *Richmond v. U.S.*, 234 B.R. 787, 789 n.1 (S.D. Cal. 1997). Since the stay is terminated and discharge denied, Smith’s motion to modify stay is moot. She and other creditors are free to pursue their nonbankruptcy remedies against Agnew.

III. Preference – 11 U.S.C. § 547(b).

The Plaintiff/Trustee has the burden of proving the avoidability of transfers under § 547(b). 11 U.S.C. § 547(g). Section 547(b) authorizes the trustee to avoid “any transfer of an interest of the debtor in property”, which the Ninth Circuit explained as follows:

The Bankruptcy Code permits a trustee to avoid any pre-bankruptcy transfer of a debtor's assets if the transfer: 1) is to or for the benefit of a creditor; 2) is for an antecedent debt owed by the debtor before the transfer; 3) is made while the debtor was insolvent; 4) is made within 90 days of the bankruptcy filing; and 5) enables the creditor to receive more than such creditor would have if the debtor liquidated and distributed the estate to all creditors 11 U.S.C. § 547(b)(1-5).

In re Food Catering & Housing, Inc., 971 F.2d 396, 397 (9th Cir. 1992).

See also In re Powerine Oil Co., 59 F.3d 969, 971-72 (9th Cir. 1995), *cert. denied*, *Koch Oil Co. v. Committee of Creditors Holding Unsecured Claims Against Powerine Oil Co.*, 516 U.S. 1140, 116 S.Ct. 973, 133 L.Ed.2d 893 (1996).

In *Barnhill v. Johnson*, 502 U.S. 393, 397, 400, 112 S.Ct. 1366, 118 L.Ed.2d 39 (1992),

the United States Supreme Court construed "transfer" 11 U.S.C. § 101(54) to mean:

“every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption.”

Section 547(e) provides further guidance on the meaning and dating of a transfer. For purposes of § 547, it provides

[(e)(1)](B) a transfer of a fixture or property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee.

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time;

(B) at the time such transfer is perfected, if such transfer is perfected after such 10 days....

Our task, then, is to determine whether, under the definition of transfer provided by § 101(54), and supplemented by § 547(e), the transfer that the trustee seeks to avoid can be said to have occurred before November 20.

"What constitutes a transfer and when it is complete" is a matter of federal law. *McKenzie v. Irving Trust Co.*, 323 U.S. 365, 369-370 (1945). This is unsurprising since, as noted above, the statute itself provides a definition of "transfer." But that definition in turn includes references to parting with "property and interest in property." In the absence of any controlling federal law, "property" and "interests in property" are creatures of state law. *Id.*, at 370; *Butner v. United States*, 440 U.S. 48, 54 (1979) ("Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law"). Thus it is helpful to sketch briefly the rights and duties enjoyed under state law by each party to a check transaction.

* * * *

We acknowledge that § 101(54) adopts an expansive definition of transfer, one that includes "every mode ... absolute or conditional ... of disposing of or parting with property or with an interest in property.

Barnhill v. Johnson's broad definition of "transfer" allows for the avoidance of judicial liens such as Smith's. See, e.g., *In re Rhoads*, 130 B.R. 565, 568 (Bankr. C.D. Cal. 1991) (filing of an abstract of judgment within 90 days of a bankruptcy filing petition constitutes a transfer of property under § 547(b)). While the Bankruptcy Code does not define "an interest of the debtor in property," the Supreme Court has interpreted the term to mean "that property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings." *Begier v. I.R.S.*, 496 U.S. 53, 58, 110 S.Ct. 2258, 2263, 110 L.Ed.2d 46 (1990). However, *Barnhill v. Johnson*'s reference to "property" requires application of state law, including Smith's counterclaim seeking constructive trust under § 72-33-219.

Plaintiff argues that the Ninth Circuit is skeptical of constructive trusts because they conflict with the bankruptcy policy of equitable treatment of creditors and ratable distribution, and circumvent the Bankruptcy Code's priority scheme by favoring certain creditors, citing *U.S.M. Workers' Comm. v. Decker (In re U.S.M. Technology Corporation)*, 158 B.R. 821, 827 n.9 (Bankr. N.D. Cal. 1993). This Court notes the sentence preceding that quoted by Plaintiff from *U.S.M. Technology*, where the bankruptcy court held that the California constructive trust statute did not apply because, unlike the instant case, the assets had not been acquired by "fraud, . . . violation of a trust, or other wrongful act." 158 B.R. at 827 n.9. This Court discusses Smith's constructive trust counterclaim below, but the evidence of Agnew's fraud against Smith in obtaining the subject property is uncontroverted and as such factually distinguishable from *U.S.M. Technology*.

Several circuit courts, including the Ninth Circuit, have concluded that under § 541(b) property that a debtor holds prepetition in a constructive trust does not enter the estate. *In re*

Lucas, 300 B.R. 526, 533 (10th Cir. BAP 2003); *Hill v. Kinzler (In re Foster)*, 275 F.3d 924, 926 (10th Cir.2001); *see also Poss v. Morris (In re Morris)*, 260 F.3d 654, 670 (6th Cir.2001); *Taylor Assocs. v. Diamant (In re Advent Mgmt. Corp.)*, 104 F.3d 293, 295 (9th Cir.1997); *Official Comm. of Unsecured Creditors of Columbia Gas Transmission Corp. v. Columbia Gas Sys. (In re Columbia Gas Sys.)*, 997 F.2d 1039, 1059 (3d Cir.1993). The Ninth Circuit in *In re Advent Mgmt. Corp.*, 4 years after the decision in *U.S.M. Technology* cited by Plaintiff, explained:

Under § 541(d) of the Bankruptcy Code, "property of the estate" includes all property in which the debtor has legal title except "to the extent of an equitable interest in such property that the debtor does not hold." 11 U.S.C. § 541(d) (West 1993).

In the case of funds held by a debtor in constructive trust for another person, the equitable interest in the trust funds belongs to the trust beneficiary, not the debtor. Accordingly, this court held in *Unicom* that funds held by a debtor in constructive trust are neither "property of the estate" under § 541(d), nor "an interest of the debtor in property" under § 547(b). [*Mitsui Mfrs. Bank v. Unicom Computer Corp. (In re Unicom Computer Corp.)*, 13 F.3d 321, 324 (9th Cir.1994).]

In re Advent Mgmt. Corp., 104 F.3d at 293. Thus, Ninth Circuit law is no bar to the imposition of a constructive trust.

The Court further does not consider the imposition of a constructive trust necessarily a circumvention of the bankruptcy policy of ratable distribution. Simply put, Smith is not similarly situated with respect to the other creditors. She has by far the largest claim, yet is the only victim of Agnew's fraud. The Plaintiff argues that the other creditors will likely receive nothing if her judicial lien is not avoided as a preference, but the record is uncontroverted that Agnew's discharge has been denied and the stay terminated. The property tax claims are a lien on the real property. The IRS has its methods and powers to collect its debt, Agnew's attorney and family member are free to collect their debt from Agnew under applicable nonbankruptcy law, as is the

credit card company which has its nonbankruptcy remedies.

What the Plaintiff requests actually adds insult to Smith's injury, because Agnew would benefit from his fraud, malice and emotional distress inflicted on Smith if the Plaintiff were to prevail by reduction of his undischarged debts to the IRS, his attorney, and credit card creditor by the amount of any distribution. Such relief in equity is not appropriate for Agnew because he does not come into court with clean hands. *See In re Marriage of Burner*, 246 Mont. 394, 397, 803 P.2d 1099, 1100 (1991); *Mitchell v. Leland Co.* (9th Cir.1917), 246 F. 103, 107; *see also Fey v. A.A. Oil Co.* (1955), 129 Mont. 300, 318, 285 P.2d 578, 587; *Tomsheck v. Doran* (1953), 126 Mont. 598, 607, 256 P.2d 538, 543; *Perry v. Luding* (1950), 123 Mont. 570, 591, 217 P.2d 207, 218.

IV. *Res Judicata* & Collateral Estoppel.

Plaintiff contends that merger¹², *res judicata* and collateral estoppel bar Smith's counterclaim for imposition of a constructive trust because she did not accomplish getting the trust imposed early enough to avoid the preference. *Res judicata* and collateral estoppel are doctrines based on Montana judicial policy favoring a definite end to litigation. *Kullick v. Skyline Homeowners Ass'n*, 2003 MT 137, ¶ 17, 316 Mont. 146, ¶ 17, 69 P.3d 225, ¶ 17 (citing *Rausch v. Hogan*, 2001 MT 123, ¶ 14, 305 Mont. 382, ¶ 14, 28 P.3d 460, ¶ 14). Under federal law "claim preclusion" has supplanted *res judicata*, which includes the doctrine of merger, and

¹²46 Am.Jur.2d *Judgments* § 502 provides that "Merger" is referred to as part of the doctrine of *res judicata* and the terms have been used interchangeably. The Montana Supreme Court in *Baertsch v. Lewis and Clark County*, 223 Mont. 206, 209-210, 727 P.2d 504, 506 (1986) concluded that the doctrine of merger and the rule against splitting causes of action are inextricably related to *res judicata*, and so merger will not be addressed separately in this decision.

issue preclusion includes the doctrines of direct estoppel and collateral estoppel to foreclose relitigation of matters which have been actually litigated. *In re Associated Vintage Group, Inc.*, 283 B.R. 549, 555 (9th Cir. BAP 2002). In the instant case the Court applies the state doctrines because of the Supreme Court's admonition to apply state law in determining property and interests in property under § 547(b) in *Barnhill v. Johnson*, 502 U.S. at 397, 400, quoted above.

Res judicata bars a party from relitigating a matter that the party has already had an opportunity to litigate. *Kullick*, ¶ 17 (citing *Olson v. Daughenbaugh*, 2001 MT 284, ¶ 22, 307 Mont. 371, ¶ 22, 38 P.3d 154, ¶ 22). Collateral estoppel is a form of *res judicata* and bars the reopening of an issue that has been litigated and resolved in a prior suit. *Kullick*, ¶ 18 (citing *Finstad v. W.R. Grace & Co.*, 2000 MT 228, ¶ 28, 301 Mont. 240, ¶ 28, 8 P.3d 778, ¶ 28).

Res judicata applies if the following four elements have been satisfied: (1) the parties or their privies are the same; (2) the subject matter of the present and past actions is the same; (3) the issues are the same and relate to the same subject matter; and (4) the capacities of the persons are the same in reference to the subject matter and to the issues between them. *Kullick*, ¶ 17, citing *Hall v. Heckerman*, 2000 MT 300, ¶ 13, 302 Mont. 345, ¶ 13, 15 P.3d 869, ¶ 13. The Court finds that as between Smith and Agnew the four above elements are satisfied, but as between Smith and the Plaintiff/Trustee none of the four elements are satisfied to a degree sufficient to bar Smith's counterclaim based on *res judicata*.

Torgenrud was not a party to the state court action, the subject matter and issues in which included the same subject property but did not in any sense include the Plaintiff's § 547(b) preference action, automatic stay issues or exemptions. The key element is whether the issues are the same. *Baertsch v. Lewis and Clark County ("Baertsch")*, 223 Mont. 206, 209-210, 727

P.2d 504, 506 (1986). At the time of the state court action the estate simply did not exist, and the capacities of the parties were not the same in reference to the subject matter and to the issues between them. In the state court action Smith was the plaintiff and constructive trust was one of her affirmative claims for relief, while in the instant adversary proceeding Smith's constructive trust claim is a defense against a claim for recovery based upon a provision of bankruptcy law which was never at issue in the state court case.

Plaintiff argues that the state court denied Smith's constructive trust claim *sub silentio*. This Court does not agree. Having reviewed Ex. 4/C, the Court finds no indication by the Court either way with respect to Smith's constructive trust claim, but otherwise the Findings and Conclusions and Judgment reflect an almost total victory for Smith. Smith's quiet title claim was denied, but under her alternative claims she was awarded judgment in the sum of \$466,911.24. The general rules of pleading in the Montana Rules of Civil Procedure allow that parties may demand relief in the alternative or of several different types. *Slater v. Central Plumbing & Heating Co.*, 1999 MT 257, ¶ 31, 297 Mont. 7, 16, ¶ 31, 993 P.2d 654, 660, ¶ 31; *Weinstein v. University of Montana at Missoula* (1995), 271 Mont. 435, 440, 898 P.2d 101, 104. The Court concludes that *res judicata* does not bar Smith's constructive trust claim.

Turning to collateral estoppel, that doctrine only applies if the following three elements have been satisfied: (1) the identical issue raised was previously decided in a prior adjudication; (2) a final judgment on the merits was issued in the prior adjudication; and (3) the party against whom the plea is now asserted was a party or in privity with a party to the prior adjudication. *Kullick*, ¶ 18. All three elements for collateral estoppel are present with respect to Smith's claims for fraud, constructive fraud and malicious prosecution against Agnew, and the facts and

conclusions with respect to such issues as set forth in Ex. 4/C are subject to collateral estoppel. With respect to the Plaintiff/Trustee, however, the first two elements are lacking.

Identity of issues is the most crucial element of collateral estoppel. *Estate of Watkins v. Hedman, Hileman & Lacosta*, 2004 MT 143, ¶ 33, 321 Mont. 419, 429-30, ¶ 33, 91 P.3d 1264, 1272, ¶ 33. In order to satisfy the identity of issues element, the identical issue or "precise question" must have been litigated in the prior action, and the fact that each action arises from the same transaction does not mean that each involve the same issues. *Watkins*, ¶ 33; *Fadness v. Cody* (1997), 287 Mont. 89, 96-97, 951 P.2d 584, 588-89. As stated above, Smith's constructive trust claim arose from the same transactions with Agnew in the state court case, but as a defense to a preference action, which did not involve the same issues. Furthermore, the constructive trust claim was not decided in the state court.

Smith's constructive trust claim was raised in the state court action, but the Judgment, Ex. 4/C, is silent on that count. "Unless it clearly appears that the precise question involved in the second case was raised and determined in the former, the judgment is no bar to the record action." *Slater*, ¶ 27; *Baertsch*, 223 Mont. at 209-210, 727 P.2d at 506, quoting *Phoenix Mutual Life Insurance Co. v. Brainard* (1928), 82 Mont. 39, 44, 265 P. 10, 12; *Brannon v. Lewis and Clark County*, 143 Mont. 200, 207, 387 P.2d 706, 710-11. This Court has reviewed Ex. 4/C, and concludes that it does not "clearly appear" that Smith's constructive trust claim was determined in the former action, and thus under the above authority the judgment is no bar to her constructive trust claim and defense in the instant adversary proceeding.

The second element for collateral estoppel requires a final judgment on the merits. The Court finds that element is lacking because Smith filed a notice of appeal in the state court action

to the Montana Supreme Court, and that appeal remains pending. Ex. G. Plaintiff cites *Rudolph* as authority that the judgment has preclusive effect even while on appeal. *Rudolph* involved an appeal from dismissal of a civil complaint brought by a pro se plaintiff, while his appeal of his criminal conviction for robbery was pending. 234 Mont. at 450, 763 P.2d at 1140. The district court had dismissed the civil complaint with prejudice on its own motion as frivolous, when there was no indication that it had been served on the persons named as defendants. *Id.* at 450-51; 763 P.2d at 1140. The Montana Supreme Court concluded that the plaintiff's 42 U.S.C. § 1983 civil rights claims in the civil action were barred by collateral estoppel as those matters were “previously argued *and ruled upon*” in the criminal case. *Rudolph*, 234 Mont. at 451, 763 P.2d at 1140 (Emphasis added). That distinction distinguishes *Rudolph* from the instant case because Smith's constructive trust claim has not been previously ruled upon, and so is not barred by collateral estoppel. Furthermore, this Court notes that *Rudolph* further concluded that dismissal of the plaintiff's claim with prejudice was premature and “not proper”, “since Mr. Rudolph's criminal conviction [was] on appeal before this Court”. *Id.* The court amended the dismissal as one without prejudice. In other words the fact there was a pending appeal in *Rudolph* limited the preclusive effect of the criminal conviction until it became final. Thus *Rudolph* not only is distinguishable in several respects from the instant case¹³, it actually undermines the Plaintiff's argument that the judgment on appeal has preclusive effect. This Court on the contrary concludes that the second element of collateral estoppel, that a final judgment on the merits was issued in the prior adjudication, is lacking both because Ex. 4/C is

¹³The instant case does not involve a criminal case, or lack of notice, or a finding that the claim in question is frivolous, all of which were involved in *Rudolph*.

silent on Smith’s constructive trust claim, and because the judgment is on appeal and not final with respect to Smith.

The reason behind allowing a subsequent and separate action is that the later action raises different issues. *Watkins*, ¶ 33. The Plaintiff’s preference claim raises different issues, albeit Smith’s constructive trust defense is the same as her Count VI. The Court declines to bar Smith’s constructive trust counterclaim on the basis of the doctrine of collateral estoppel.

The Court concludes this section with reference to the Restatement of Judgments, Second (1982) § 26 (1982), “Exceptions to the General Rule Concerning Splitting”:

(1) When any of the following circumstances exists, the general rule of § 24¹⁴ does not apply to extinguish the claim, and part or all of the claim subsists as a possible basis for a second action by the plaintiff against the defendant:

* * * *

(d) The judgment in the first action was plainly inconsistent with the fair and equitable implementation of a statutory or constitutional scheme, or it is the sense of the scheme that the plaintiff should be permitted to split his claim

In this Court’s view, § 26(1)(d) provides additional support for its conclusion that Smith should not be precluded from asserting her counterclaim for imposition of a constructive trust in this adversary proceeding. It is not that the judgment in the first action was plainly inconsistent with the fair and equitable implementation of a statutory or constitutional scheme, but it is the sense of the Bankruptcy Code and this Court that Smith should be permitted to assert her constructive trust counterclaim as a defense to the Plaintiff’s preference claim.

¹⁴Section 24 is entitled “Dimensions of ‘Claim’ for Purposes of Merger or Bar – General Rule Concerning ‘Splitting’”.

V. Constructive Trust.

Smith's counterclaim seeks imposition of a constructive trust, which is provided for at Mont. Code Ann. § 72-33-219:

Constructive Trust. A constructive trust arises when a person holding title to property is subject to an equitable duty to convey it to another on the ground that the person holding title would be unjustly enriched if he were permitted to retain it.

The Ninth Circuit earlier this year explained Montana's constructive trust doctrine in *United States v. Nava* 404 F.3d 1119, 1130-31 (9th Cir. 2005):

The "constructive trust" doctrine "arises when a person holding title to property is subject to an equitable duty to convey it to another on the ground that the person holding title would be unjustly enriched if he were permitted to retain it." Mont. Code Ann. § 72-33-219. Generally, "fraud, accident, mistake, undue influence, and violation of a trust, or other wrongful acts are the bases upon which a constructive trust is found," but a constructive trust may also be imposed "where a title holder innocently obtained title but would be unjustly enriched if they were allowed to retain the title." *In re Marriage of Moss*, 293 Mont. 500, 977 P.2d 322, 327 (1999). *See also United States v. \$4,224,958.57*, 379 F.3d 1146 (9th Cir.2004)("[I]t is hornbook law that, when a fraudster acquired property from a victim by fraud, the fraudster holds the property in constructive trust for his victim." (citing Scott on Trusts § 462.4 (4th ed.1989))). "Thus, Montana law no longer requires a showing of fraud or other wrongful acts as a prerequisite to imposing a constructive trust...." [*In re Estate of McDermott*, 2002 MT 164, ¶ 25, 310 Mont. 435, 441-42, ¶ 25, 51 P.3d 486, 491, ¶ 25].

Based on Ex. 4/C, which is not disputed by the Plaintiff and is subject to the doctrines of *res judicata* and collateral estoppel as between Smith and Agnew, the Court finds more than enough evidence of fraud, wrongful acts, and unjust enrichment if Agnew were allowed to retain the title to impose a constructive trust. Ex. 4/C sets forth Judgment against Agnew for fraud, constructive fraud, malicious prosecution of dissolution of a nonexistent common law marriage, and emotional distress caused to Smith. If a constructive trust is not imposed Agnew would

continue to benefit from his fraud and enjoy unjust enrichment by the reduction of his undischarged debt which would result if the Plaintiff prevails, liquidates the subject property, and makes a distribution to creditors. Under the evidence shown in this record, a conclusion that a constructive trust arose is appropriate. Even if the established fraud and wrongful acts arising from the state court decision did not exist, the record of established facts reflecting unjust enrichment is more than sufficient to impose a constructive trust in this case.

It is an elementary mistake to suppose that a court creates the trust. *United States v. \$4,224,958.47*, 392 F.3d 1002, 1004 (9th Cir. 2004), citing Scott on Trusts § 462.4 (4th ed.1989). The Ninth Circuit explained: “The expression ‘the court constructs the trust is ‘absurd’. The obligation on the fraudster is imposed by law and arises *immediately* with his acquisition of the proceeds of the fraud.” *United States v. \$4,224,958.47*, 392 F.3d at 1004 (superseding earlier opinion) (emphasis added). In that case the Ninth Circuit held that assets fraudulently collected were impressed with a constructive trust, and ordered the United States to administer the trust for all potential claimants. *Id.* at 1004-05.

Likewise in the instant case, this Court finds and concludes that the subject property obtained by Agnew was impressed with a constructive trust under § 72-33-219 in 2001 when he fraudulently obtained the warranty deed to the subject property in his own name. That takes the transfer for purposes of § 547(b)(3) well outside the 90 day or 1 year lookback period under that subsection, and further defeats the Plaintiff’s preference claim as well as any Trustee “strong arm” powers under 11 U.S.C. § 544(a), which are established by statute “at the time of commencement of the case”. Unlike the above-cited case, no further administration of the subject property will be permitted by Agnew or the Trustee, but instead Smith will be allowed to

proceed with execution of her judgment without further delay.

One final result of the imposition of a constructive trust involves the objections to Agnew's claimed homestead exemptions in the subject property, filed by Smith and the Plaintiff. The law in the Ninth Circuit and other circuits, cited above in *In re Advent Mgmt. Corp.*, 104 F.3d at 293, is that assets held by a debtor in constructive trust are neither "property of the estate" under § 541(d) nor "an interest of the debtor in property" under § 547(b). *See also In re Lucas*, 300 B.R. at 533; *In re Unicom Computer Corp.*, 13 F.3d at 324. Agnew claimed his homestead exemption pursuant to 11 U.S.C. § 522(b) and applicable state law, but § 522 authorizes a debtor to exempt "from property of the estate". The subject property impressed herein with a constructive trust is necessarily not property of the estate, and thus not subject to Agnew's claim of homestead exemption under § 522(b) or applicable state law. In one sense the objections are therefore moot, but to eliminate any doubt and unnecessary delay Smith's and the Trustee's objections to Agnew's homestead exemption will be sustained and the Debtor's claimed homestead exemption disallowed. With respect to Smith's other objections to exemption in office equipment and farm equipment, there was no evidence offered in support of those objections at trial. With the stay terminated and discharge denied those disputes are left for another, nonbankruptcy forum.

CONCLUSIONS OF LAW

1. This Court has jurisdiction over this case under 28 U.S.C. § 1334(b).
2. The pending matters are core proceedings under 28 U.S.C. § 157(b)(2).
3. Smith's motion to modify stay is moot because Agnew's discharge was denied, and under 11 U.S.C. § 362(c)(2)(C) the stay was terminated on July 26, 2005.

4. Smith's counterclaim for imposition of a constructive trust is not bound by the doctrines of merger, *res judicata*, or collateral estoppel because the issues are not the same in this preference proceeding, there is no final judgment from the state court on Smith's claim for constructive trust because that judgment is on appeal, and equitable considerations and the Court's sense of the Bankruptcy Code result in the conclusion that Smith should be permitted to assert her constructive trust counterclaim.

5. The undisputed fraud, wrongful acts, and unjust enrichment of Agnew shown by Ex. 4/C provide preclusive effect and ample support for the imposition of a constructive trust on the subject property under Mont. Code Ann. § 72-33-219, as a result of which the subject property is neither property of the estate under § 541(d) nor "an interest of the debtor in property" under § 547(b). *In re Advent Mgmt. Corp.*, 104 F.3d at 293; *In re Lucas*, 300 B.R. at 533; *In re Unicom Computer Corp.*, 13 F.3d at 324.

6. The objections to Debtor's claim of homestead exemption filed by the Trustee and Smith are well taken because the subject property is not property of the estate under 11 U.S.C. § 522(b) or 541(d); Smith's other objections to exemption are unproven and will be denied without prejudice.

IT IS ORDERED a separate Judgment shall be entered for the Defendant Susan L. Smith ("Smith") on her counterclaim imposing a constructive trust against the above-described real property located in Lake County, Montana, listed in the Debtor Robert Eugene Agnew's Schedule A, and dismissing Trustee/Plaintiff's complaint against Smith based upon 11 U.S.C. §§ 547(b) and 550, and § 544(a); and further denying the Plaintiff's motion to avoid Smith's judicial lien, filed May 20, 2005.

IT IS FURTHER ORDERED a separate Order shall be entered in conformity with the above denying Smith's motion to modify stay filed July 23, 2004, on grounds of mootness; sustaining Smith's objection, filed July 23, 2004, and the Trustee's objection, filed May 20, 2005, to Debtor's claim of homestead exemption and disallowing Debtor's claimed homestead exemption in the above-described subject real property.

BY THE COURT

A handwritten signature in cursive script, reading "Ralph B. Kirscher", is written over a horizontal line.

HON. RALPH B. KIRSCHER
U.S. Bankruptcy Judge
United States Bankruptcy Court
District of Montana